INFORMATION 63

LEGAL IMPLICATIONS IN COORDINATING ACTIVITIES OF BARGAINING ASSOCIATIONS

FARMER COOPERATIVE SERVICE • U.S. DEPARTMENT OF AGRICULTURE

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Farmer Cooperative Service conducts research; advises directly with cooperative leaders and others; promotes cooperative organization and development through other Federal and State agencies; and publishes results of its research, issues News for Farmer Cooperatives, and other education material.

This work is aimed (1) to help farmers get better prices for their products and reduce operating expenses, (2) to help rural and small-town residents use cooperatives to develop rural resources, (3) to help these cooperatives expand their services and operate more efficiently, and (4) to help all Americans understand the work of these cooperatives.

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A challenge of particular importance to bargaining associations interested in coordinating their activities is to see if they can create a sound legal basis for such action. Objective of such coordination falls right in line with growers primary objective in first setting up a bargaining association—that is, to provide themselves with leverage to improve the level of prices they receive.

Such further coordination can range all the way from a simple form of informal cooperation by two or more cooperatives in one local market to the formal and legal merger or consolidation of two or more associations. Or as an intermediate step, bargaining associations might first work out a formal contractual arrangement to use the services of a common representative or broker in a market and then, second, form a separate corporation to do their marketing or sales function.

This publication focuses primarily on the broad legal aspects of five types of coordinated activities bargaining associations can consider. It does not go into the feasibility of mergers from the standpoints of economics and marketing or of the human elements involved.

Nor, except in a general way, does this report cover detailed rules of the game that may be included in relevant contracts, agreements, or organization papers that authorize such coordinated efforts and that protect the rights of members under such arrangements.

These technical matters are best left to management and legal counsel. They would be familiar with the peculiar operating problems and economic objectives of such coordinated efforts.

The ultimate direction bargaining associations take

should be chosen after the benefit of competent legal counsel on such matters as:

1. Basic statutory authority of the respective organizations to enter into a merger, consolidation, or other form of coordinated action.

2. Preparing plans and agreements, as well as guidance through the mechanical and technical procedures, including membership approval, where necessary, of such plans and agreements.

3. Preparing new or revised member-association agreements as well as processor-association agreements.

4. Compliance with tax, antitrust, blue sky, agricultural fair practices, and other laws.

5. Assurance that cooperative character is maintained through provisions in the organization papers dealing with such matters as the producer and patronage status of members, democratic control, service at cost, and methods of financing.

Forms of Coordinated Activities

In bargaining associations, loss of identity often holds back membership approval of merger proposals. And if the associations bargain for different commodities, their respective members may want to retain a form of organization structure that retains degrees of identity, flexibility, and independence in handling individual commodities. This is necessary to satisfy the growers of these commodities. But the form the organization takes must contain enough merged activity to lead to more effective selling and improved returns.

Each of the five possible forms discussed in this report is progressively tighter in terms of management-membership control. The five are: (1) Integrated service activities, (2) advisory price committee, (3) price sanction committee with decisional authority, (4) coordinated sales, and (5) operating a single pool.

All five may be carried out under alternative membership structures, either federated or centralized membership.

Under a federated membership, present associations would maintain their corporate identities.

Under a centralized membership, present organizations lose their identities and their grower-members become direct members of a surviving or new bargaining association.

I.
Integrated Service Activities

The first form of coordinated activity includes integration of all or most service activities. These include housing, secretarial, office equipment and facilities, field staff, economic and statistical services, public and legislative relations, accounting and auditing services, and other similar services.

However, bargaining for price and other terms of trade for each product would be handled, as they are now and as they were in the past, by the present organizations in a federated organization, or by commodity sections within a centralized organization with full and independent authority to carry out the bargaining function.

The question is: Are there legal implications if these service functions are performed on an integrated basis by a new federated organization or by a new entity emerging as a result of a merger or consolidation but with the bargaining function performed by commodity sections?

The Federated Route

The bargaining associations may form and compose the membership of a new cooperative—one we might call a Service Cooperative—to perform the above-named services. In that case, some question may arise on whether the new cooperative would qualify under the Capper-Volstead Act.

The Capper-Volstead Act allows farmers to act together in cooperative marketing associations without

the associations *as such* being held to be "illegal combinations" or "conspiracies in restraint of trade" as they otherwise might have been in pre-Capper-Volstead days.

The Capper-Volstead Act provides that agricultural producers may act jointly to process and market the products of its members as long as the association is operated for the mutual benefit of the members and certain voting and other requirements are met.

There is a chance the Service Cooperative might not be considered a marketing cooperative. In this event, Section 6 of the Clayton Act might be the authority that confirms its legal right to exist and "lawfully" carry on its "legitimate objects," but the Section would not exempt it from the anti-trust laws.

Section 6 of the Clayton Act still performs an important function in legitimizing the existence of farm supply and service cooperatives.[1]

The Merger Route

To maintain full independence of the bargaining function by commodity sections should associations merge, the pattern followed by a Midwest dairy cooperative might be considered.

The bylaws of the dairy co-op provide for a district as well as a central board of directors. Growers in separate commodity districts elect each district or commodity section board. The district board derives its authority from the association's bylaws. These provide full independence within the realm of the powers and authorities described in the bylaws. The commodity section board of the merged organization could have the authority to approve the form and contents of a marketing agreement between the association and the member-parties.

An alternative approach, if acceptable to commodity section directors, would give the central board authority to delegate the bargaining function to commodity section directors. The central board can revoke delegations

[1] Mischler, R. J., *Agricultural Cooperative Law,* Rocky Mountain Law Review, 1958.

of authority, however, thus destroying the full independent character of the commodity section board.

II.
Advisory Price Committee

The second form of a coordinated activity, patterned after the first, would provide fully integrated service functions with independent bargaining functions.

The modification for the second form would be an overall price committee to review the proposed price offers of each commodity section. The committee would have the authority to suggest, not require, changes in the proposed price offers and other proposed terms of trade if they are judged to be out of line.

The Federated Route

An added function of the Service Cooperative in the federated route is that the price committee would serve in a purely advisory capacity. Bylaws of the Service Cooperative could provide for the formation, purpose, qualifications of its membership, and mode of operation for such a committee.

In the first example of coordinated activity, we assume that the Service Cooperative is not a Capper-Volstead cooperative.

The Agricultural Marketing Act of 1926 confirms the legality of member associations of the federation cooperating with the Service Cooperative in establishing prices even if the service organization may not meet Capper-Volstead requirements.

The 1926 Act provides that agricultural producers and their associations might legally acquire and exchange past, present, and prospective pricing, production, and marketing data "by direct exchange between such persons, and/or such associations or federations thereof, *and/or by and* through a common agent created or selected by them." (Emphasis supplied.) The common agent does not necessarily have to meet Capper-Volstead requirements.

The Merger Route

An overall advisory price committee established within a merged organization would not appear to present any legal problems. This is because all price review discussions would be within the organization.

III.
Price Sanction Committee

The third form of coordinated activity would be patterned after the first and second except that the price committee would have the authority to require changes in price offers proposed by the commodity sections if the price offers, or other proposed terms of trade, are judged to be out of line. The veto power of the overall price sanction committee would be duly authorized.

The Federated Route

Under these conditions, processors would still negotiate directly with the bargaining associations. It would be of little or no consequence to a processor if voluntary or mandatory price committees were used by the bargaining associations in determining price and trade-term offers.

A nonmember bargaining association may want to avail itself of the economies of scale derived from the use of the Service Cooperative. This could be accomplished through a contractual relationship with the Service Cooperative. As a matter of policy, however, such services may not be available except to federated members.

The question thus arises: Could the nonparticipating bargaining association have reason to complain that its competitive position is being jeopardized because it is not able to have the economies of scale that the Service Cooperative affords?

The answer to this question appears to be no. The objective of the Service Cooperative would be to achieve

economies of scale. The price sanction function may give the Service Cooperative greater bargaining power by improving price determinations. The nonparticipating bargaining association would have no basis for complaint if the federated cooperative could clearly establish that its motives have always been to improve its members' returns—not to foreclose competition or restrain trade.

For example, if they became dissatisfied with their association, the members of the nonparticipating bargaining cooperatives could voluntarily terminate their membership and, if eligible, reaffiliate with a member of the federated group. The nonparticipating cooperative would have no basis to complain if the action complied with either Federal or State agricultural fair practice laws.

The Merger Route

An overall price sanction committee, with power to require changes in price offers and terms of trade proposed by commodity sections, would derive its power from agreements in the organization papers. Members of the merged organization obviously would have to abide by their own rules of the game.

Because a sanction committee would have this power to make changes, somewhat less than full independence in price bargaining would be maintained by the commodity sections. Over the long term, perhaps the price sanction committee might ultimately assume the price bargaining function.

In anticipation of such a development, perhaps some growers might vote against the merger proposal. Thus, the problem of compensating dissenting members must be anticipated and dealt with according to the State law.

Another problem might be the insistence by some growers that because a proposed merger would create a new legal relationship between growers and the surviving association, a new membership agreement would have to be signed.

This problem can be anticipated and handled in the merger agreement by a provision that assures continu-

ance of all membership and sales agreements held by the constituent associations with their respective members before the merger. Moreover, the statute authorizing the merger may expressly provide for continuing the agreement.

The merger agreement could provide for adopting a uniform membership agreement for all members or for a certain class or classes of members such as in commodity sections. The agreement would be effective when executed by the surviving association and its respective members.

Laws in most States provide that a surviving organization or consolidation succeeds "without other transfer, to all the rights and property of each of the constituent corporations, and shall be subject to all the debts and liabilities of each, in the same manner as if the consolidated or surviving corporation had itself incurred them."

The court's decision in *Stevens* v. *Selma Fruit Company,* (1912) 123 P. 212, 18 C. A. 242, held that contracts are assumed by the purchasers of a business when the purchase contract includes a provision whereby the buyer agrees to assume all contracts of the selling company. The *Selma* case, however, related to an acquisition rather than a merger.

IV.
Coordinated Sales

The fourth type of coordinated action by bargaining associations is coordinated or package sales. Prices would be negotiated as described in the second or third suggested forms of organization, but quantities would be coordinated through negotiations with processors.

The Federated Route

Section 3 of the Clayton Act makes package or coordinated sales illegal "where the effect may be to substantially lessen competition or tend to create a monopoly." [2]

[2] Backman, Jules, *Price Practices and Price Policies,* The Ronald Press Co., New York, N. Y. 1953.

For example, if one of the bargaining association members of the federated organization—the X product group—attempted to require a potential processor to buy or bargain for certain quantities of product Y or product Z, as a prerequisite for a contract to purchase product X, a question could be raised on whether the product X group would be complying with Section 3 of the Clayton Act.

If the buyer refused to buy or bargain with the product Z grower bargaining group, thereby shutting off his supply of product X, he may have a basis to bring suit. Under his operating circumstances, he could claim he was closed out of the product X market.

The Merger Route

Even though administering coordinated sales is easier in a merged organization than a federation, there is still the problem of possible violation of Section 3 of the Clayton Act with the merger route.

For example, approximately 99 percent of all cling peaches are grown in California, but tomatoes are grown over widespread areas of the country. Thus, a particular canner's refusal to buy or bargain with a tomato bargaining division could possibly have the effect of shutting off his cling peach supplies. Even if a canner could get adequate supplies of cling peaches from nonmember growers, there is a question about the legality of coordinated sales.

V.
Operating a Single Pool

The fifth, and final, type of merged organizational activity assumes the existence of an overall price sanction committee with a specific authority. This committee could require changes in the price offers or terms of trade proposed by commodity bargaining sections under any form of formal membership structure if it considers these out of line.

In contrast to multiple or commodity pooling—a system previously considered as the usual method for making payments to producers—it is assumed that returns to growers are based on a single-pool concept comparable to that used by a canning cooperative.

For example, all commodities marketed by the organization are handled in one pool for final returns made to growers.

The Federate Route

In the single-pool concept, the federation's board of directors has the authority to establish the single pool. This authority is generally found in the bylaws and should be stated in membership agreements so members fully understand. No particular legal problem precludes either the single-pool concept or the vesting of such authority with the federation's board of directors.

The Merger Route

Giving the central board authority to establish a single pool raises no legal problem. As long as members and nonmembers, if any, are treated equitably, there should be no federal income tax problem in either a single or multiple pool operated under a federated or completely merged organization.

Federal Income Tax Implications

Bargaining associations obtain financing through per-unit capital retains and deductions for operating purposes. Under per-unit retain financing, the patron agrees to furnish capital based on the dollar value, or physical volume, of products marketed through the cooperative. These amounts are reflected in the association's net worth.

On the other hand, deductions from marketing proceeds for operating purposes, as well as service charges paid by processors, comprise a bargaining association's primary income. After paying all operating expenses,

the balance is distributed, either as patronage refunds, or retained.

If paid as patronage refunds, special rules for tax treatment are given under Subchapter T of the Internal Revenue Code (IRC) of 1954. In general, these rules provide that if the patron consents, he is taxed. If not, the cooperative pays a tax at the corporate level because it gets no current deduction for patronage refunds.

Amendments to Subchapter T made in 1966 make per-unit capital retains subject to income tax treatment at either the cooperative or the patron level similar to that applicable to patronage refunds. Under the 1966 amendment, a cooperative pays the tax currently unless its per-unit retains are evidenced by certificates that are *qualified* under the law.

The patron is required to pay the tax if he gets a qualified certificate. The certificate is qualified only if the patron agrees to include in his gross income the face amount of the certificate received. If he gets a nonqualified certificate, he reports the amount received only when it is redeemed, sold, or otherwise disposed of.[3]

Under any form that joint or coordinated efforts may take, association officials should clearly understand Subchapter T as well as Section 521 requirements of the IRS Code. They must understand the detailed requirements as a basis for their decisions if the bargaining association or its members will pay Federal income taxes on net operating savings generated by the cooperative or the bargaining association, or its members will pay Federal income taxes on per-unit capital retains.

Other Observations By Attorneys

The preceding discussion primarily concerns the antitrust implications of the various forms of potential coordinated activity. It is in these antitrust areas that processors and canners would seek legal redress if

[3] Volkin, D. and Neely, D. M., *Tax Laws Changed on Capital Retains,* Reprint 328, News for Farmer Cooperatives, March, 1967.

growers make efforts to strengthen their bargaining power through their bargaining associations.

We reviewed these functional alternatives with some attorneys for bargaining associations. They could not be too specific about the legal implications involved for essentially two reasons.

First, the discussions had no specific organizational or operational framework as a basis for analysis. Second, the law itself is not clear as to the degree of coordinated action that may be considered by the Department of Justice or by the processors themselves as an unlawful monopoly or conspiracy to monopolize.

In discussing the various kinds of coordinated activities, their responses showed a variety of concerns, not all in antitrust areas. Their observations are summarized as follows:

1. The complete merger of bargaining associations would not violate State or Federal antitrust laws. Problems could arise, however, if the resulting or surviving organization engaged in anticompetitive or predatory practices. An example of a predatory practice would be the refusal to sell to a processor for the express purpose of driving that firm out of business.

2. Attaining substantial, even monopoly, control over the marketing of certain agricultural products should not create any problem so long as such control does not have the effect of unduly enhancing prices or causing the association to engage in predatory practices.

3. The Supreme Court's December 18, 1967, decision in *Case-Swayne Co.* v. *Sunkist Growers, Inc.,* affirms the need for cooperative marketing organizations to periodically check their membership rolls to make sure nonproducers are not included if Capper-Volstead requirements are to be met.

4. A merger agreement should provide for an equitable exchange of equity interests. The principle of equity should especially be preserved in any kind of pooling arrangement.

5. The single pool concept creates no legal problem if the pooling methods are appropriately authorized.

6. Differences in marketing outlets, market order protection, and pooling practices all contribute to placing grower-members of the respective bargaining cooperatives in different legal relationships with their associations.

Because membership agreements reflect these differences, one attorney expressed the strong opinion that if a statutory merger occurred, a complete new sign-up of members would have to take place. He believed his view is strengthened because the present membership structure of associations he represents include county or area local associations that are either bargaining cooperatives or cooperative shipping houses seeking processing outlets. These association members further complicate the problem and emphasize the need for a new membership agreement.

7. Methods of financing, revolving out of capital contributions or retained savings, maintaining allocated or unallocated reserves, and related Federal income tax problems are all matters that must be considered.

Other Publications Available

Farmers Rights Under the Agricultural Fair Practices Act, Information 60.

Collective Bargaining for Poultry Feed Prices—California, General Report 141. D. B. DeLoach and J. A. Maetzold.

Cooperative Bargaining by Farmers—A Selected Bibliography, General Report 123. Wendell M. McMillan.

Improving Farmers' Income Through Cooperative Bargaining, Information 41. Wendell M. McMillan.

Some Facts About Fruit and Vegetable Bargaining Co-ops, Information 11. Wendell M. McMillan.

A copy of each of these publications may be obtained upon request while a supply is available from --

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